



IRA A. JACKSON  
COMMISSIONER

# *The Commonwealth of Massachusetts*

*Department of Revenue*

*Loarett Saltonstall Building,*

*100 Cambridge Street, Boston 02204*

June 1, 1983

I. You inquire as to the Massachusetts income tax treatment of interest, dividends, and other earnings on investments in so-called "wraparound annuity" contracts or "tax-deferred annuity" contracts.

A "wraparound annuity" or a "tax-deferred annuity" contract is an arrangement in which an individual places his money in an investment such as a mutual fund, money market account, savings account or certificate of deposit with the intent of deferring income taxes on the accumulated earnings. The contract provides that the accumulated funds may be used to purchase an annuity at some future date.

Prior to 1982, the Internal Revenue Service issued revenue rulings regarding the tax treatment of earnings on such investments. If the annuity "policyholder" had control over individual investment decisions or if the underlying investment was available for purchase not only by the prospective annuity purchaser, but by the members of the general public, then the "policyholder" was considered the owner of the investment for federal income tax purposes and earnings were includible in federal gross income in the year earned. (Rev. Rul. 81-225, 1981-41).

The Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") (P.L. 97-248) codified federal tax treatment of earnings on "wraparound" and "tax-deferred annuity" contracts entered into after August 13, 1982. Partial surrenders or

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cash withdrawals from such annuity contracts prior to the annuity starting date will be treated as income to the extent that the cash value of the contract exceeds the investment in the contract. (I.R.C. s. 72(e)).

Massachusetts gross income is federal gross income as defined under the Internal Revenue Code as amended on November 6, 1978, with certain modifications not here relevant. (G.L. c. 62, s. 2(a)). Therefore, Massachusetts follows pre-TEFRA rules with respect to the income tax treatment of earnings on such annuity contracts entered into after August 13, 1982, as well as earlier contracts.

Earnings on investments in "wraparound annuity" contracts and "tax-deferred annuity" contracts will be deferred from Massachusetts income taxation only if the earnings would be tax-deferred for federal income tax purposes under the 1954 Code as amended on November 6, 1978.

II. You inquire whether Massachusetts requires the withholding of income taxes on periodic and non-periodic distributions and on the payment of interest.

Income is subject to Massachusetts income tax withholding if it is both taxable under Massachusetts General Laws Chapter 62 and consists of "wages" as defined in Code Section 3401(a) or pension or annuity payments with respect to which there is a voluntary withholding agreement as provided in Section 3402(o) of the Code. (G.L. c. 62B, ss. 1 and 2). "Code", for purposes of Massachusetts income tax withholding, means the Internal Revenue Code currently in effect. (G.L. c. 62B, s. 1).

Persons who make payments under an annuity contract are required to withhold federal income tax unless the recipient directs that such withholding not be made. (I.R.C. s. 3405). Prior to P.L. 97-248, federal income taxes were not required to be withheld from distributions under an annuity unless the recipient requested that withholding be made. (I.R.C. s. 3402(o)).

Interest and dividends paid or credited after June 30, 1983 to individuals and unincorporated entities such as partnerships and estates are subject to federal withholding, unless otherwise exempted. (I.R.C. ss. 3451 and 3452). Prior to P.L. 97-248, interest and dividend payments were not subject to federal income tax withholding.

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Periodic and non-periodic distributions and payments of interest and dividends are not wages as defined in Code Section 3401(a). Code Section 3402(o) has been revised by P.L. 97-248 and is not applicable to periodic and non-periodic distributions. (Code s. 3402(o)(6)).

Payments of interest and dividends are not subject to Massachusetts income tax withholding.

Periodic and non-periodic distributions are not subject to Massachusetts income tax withholding, except for pension or annuity payments with respect to which there is in effect a withholding agreement under Code Section 3402(o).

Very truly yours,

A handwritten signature in dark ink, appearing to read "R. O. Johnson", is written over the printed name of the Commissioner of Revenue.

Commissioner of Revenue

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